Bouncing Back

OPR rate cut implications to stock recommendations

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BNM cut the overnight policy rate (OPR) last week. This move was a pre-emptive one, and it came as a negative surprise to Kenanga's forecast. However, if historical patterns are reliable precedents, with the exception of Covid-19 period, the FBM KLCI had always bounced back higher post a rate cut , under a 12-month basis (exhibit 1), and the most reliable sector to see outperformance would be banks, in our view.

Admittedly, the near-term 3QCY25 outlook is somewhat clouded as investors gauge whether another OPR cut may be necessary amid ongoing challenges in tariff negotiations. Cues of this may come from bond market, as demand shifts to short-term exposures and yields on short-tenured bonds may fall faster than longer-tenured ones. Such an environment in the past played most positively for utilities (beating telcos and cyclicals such as banks), adding a tactical angle to overweight the utilities sector which we now push as one of the key sectors for 3QCY25. Banks' valuation are still appealing though the immediate catalyst of averting a rate cut didn't play out. In addition to these two sectors, construction, renewable energy, and gloves form our key sectors for 3QCY25.

Our market earnings growth forecast is lowered to 3.0% from 3.5%, as we trimmed banks' earnings to factor in NIM impact and we haven't considered offsetting effects Our overall strategy of preferring laggards plays within key sectors, as liquidity shored up is being put to use, still remains. This benefits the likes of YTLPOWR (OP; TP: RM4.73), IJM (OP; TP: RM3.40), SIME PROP (OP; TP: RM1.79), IHH (OP; TP: RM8.11) and CIMB (OP; TP: RM7.90). Please see fig 7-9 for our full list of 3QCY25 market recommendations.

Examining returns profiles post a rate cut for the Malaysian sectors

Empirical data suggests banks should do well on a 12-month basis. Bank Negara's latest OPR cut was a pre-emptive one, i.e. not based on existing weakness in data points, but we think cues from past patterns on how sectors would trade subsequently can still serve as a good reference point. Historically, post a domestic rate cut, the 12-month return typically shows that the FBM KLCI's 12-month index returns post a rate cut was in the positive 3 out of 4 occasions since 2009 (with an average return of 9%). Among these, the financials sector have historically fared better with the exception of the May 2019 OPR cut, if we exclude the technology sector which is exposed to global supply chain factors. This is expressed in relative terms to the FBM KLCI performance.

Exhibit 1: 12-month BURSA Sectoral Index Level Returns from Date of First OPR Cut (Displayed in Relative Terms to the FBM KLCI)

OPR cuts	Utilities	Healthcare	Consumer	REITS	Property	Energy	Construction	Telco	Plantations	Financials	Technology
Nov 2009	-25%	n.a.	-11%	n.a.	5%	11%	9%	n.a.	18%	19%	-18%
Jul 2016	-12%	-17%	-1%	-1%	8%	26%	14%	-10%	-2%	11%	59%
May 2019	4%	9%	-5%	2%	-20%	-19%	-8%	12%	2%	-12%	22%
Jan 2020	-7%	-12%	-10%	-18%	-15%	-35%	-20%	-1%	-5%	-3%	93%
Average Outperformance/ (underperformance)	-10%	-7%	-7%	-6%	-6%	-5%	-1%	0%	3%	4%	39%

Source: Kenanga Research, Bloomberg.

Note: includes Kenanga estimates when index levels are not available. In the 12-months subsequent to the rate cuts in 2009, 2016, 2019 and 2020, the FBM KLCI returned +45%, +6%, -16% and +1% respectively, on an absolute basis.

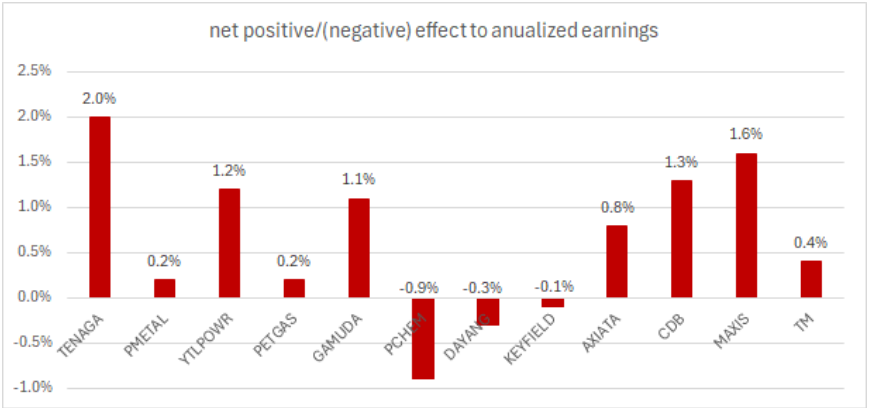
A tactical playbook in 3QCY25 for utilities amid tariff negotiations. On a 12-month basis, historically, the utilities sector performed less well after the onset of a rate cut. Kenanga Economists sees that there will be no more rate cut for the rest of the year, unless GDP growth drops below 3.5% or if external conditions worsen, then BNM may have room to ease further. Nevertheless, we have flagged a mild bull-steepening bias. This terminology describes a scenario where short-term bond yields fall faster than longer-term bond yields as investors typically favour shorter-term investments, which may be brought about by expectation of additional rate cuts. Utilities tend to outperform in such a phase, and 3QCY25 would likely offer such tactical playbook. This is amid the complexity of US tariff discussions ahead of the 1 August effective implementation date, where Malaysia via its Investment, Trade, and Industry Minister has said that Malaysia is taking a measured approach to tariff negotiations, being mindful of broader implications.

On the other had, we also saw very little evidence of a rate cut being correlating well with improved stock returns in the consumer sector. Specific for consumer, we watch for the fact that higher disposable income from the OPR cut may be offset by the inflation cost-pass-through from businesses to the consumer.

Taking cues from bond yields

Interest savings slight from the 25 bps OPR cut, though we prudently reduce our bank earnings estimate. We observe that the 25 bps rate cut is not expected to move the needle for the sectors under coverage in terms of interest savings, as these hover less than 2% to earnings (on an annual basis). We foresee some savings accruing to Utilities and Telco names, but expect to see opposite effect ringing true for the Oil and Gas sector as the players are generally in net cash position; some of them have employed hedging strategies, true for the likes of **MISC** and **YINSON**. We have trimmed our expectation of banks' earnings growth to 3.7% (from 5.0%) as we more prudently impute the impact of the rate cut to NIM as this ran contrary to our initial expectation of no rate cut.

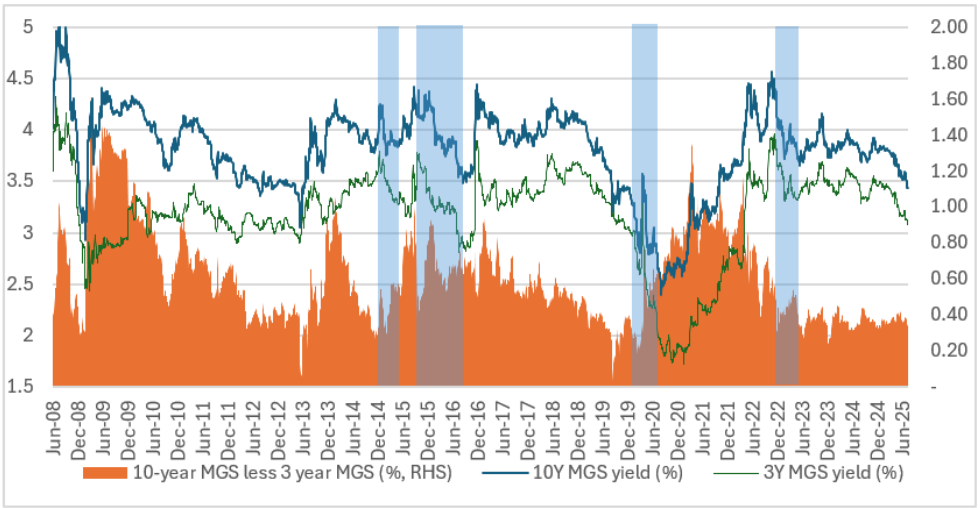
Exhibit 2: Annualized Interest Cost Savings Expressed as a Proportion of Earnings



Source: Kenanga Research, Companies

Utilities tended to perform best under bull-steepening stretches, beating other "steady sectors" and cyclicals. Using the yields on a 3-year MGS as a proxy to shorter-term bond tenures, and using 10-year ones as a gauge of longer-term bonds, the blue shaded area (in exhibit 3) corresponded with periods which exhibit bull-steepening. Under such an environment in the past, the sectors that tended to perform better are more defensive in nature such as utilities and healthcare (referring to IHH and KPJ, excluding gloves). Utilities generally beat even telcos which was relatively steady, while also outstripping the banking sector's returns.

Exhibit 3: 3Y and 10Y MGS Yields, Highlighting In Blue the Areas Where Short-term Rates Fell Faster Than Long-term Rates (Bull Steepening Effect)

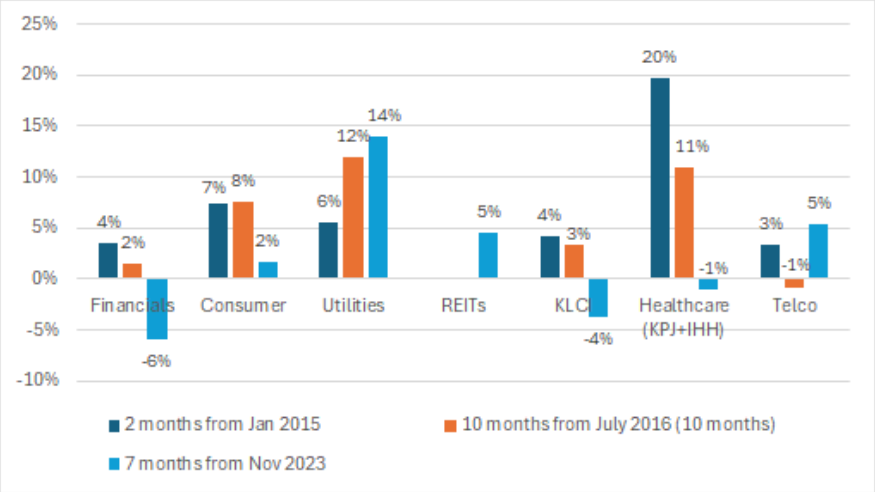


Source: Kenanga Research, Bloomberg

Utilities also has positive fundamental catalyst in the near term. We also highlight that the utilities sector is not short of catalyst in the near term in the form of new capacity bids and brownfield opportunities. Chief among them, the Energy Commission has invited Requests for Proposals (RFPs) for: (i) new generation capacity, (ii) extension of gas-fired PPAs, and (iii) additional capacity from existing gas-fired power plants. We believe **TENAGA** (OP; TP: RM17.20) and **MALAKOF** (OP; TP: RM0.77**)** are strong contenders due to their existing brownfield assets. We also expect **YTLPOWR** to be keen to explore new power plant project. Separately, some of the utilities names also make a strong argument for being able to offer attractive dividend yields, such as in the case of **GASMSIA** (MP; TP: RM3.93), at 5.7% yield.

Exhibit 4 below zooms into a few sectors (non-exhaustive) with reference to Exhibit 3 above. The sample generally reflects an environment without a recession as the Covid-19 period data in 2019/2020 has been excluded given that returns would be skewed by pandemic-time volatility.

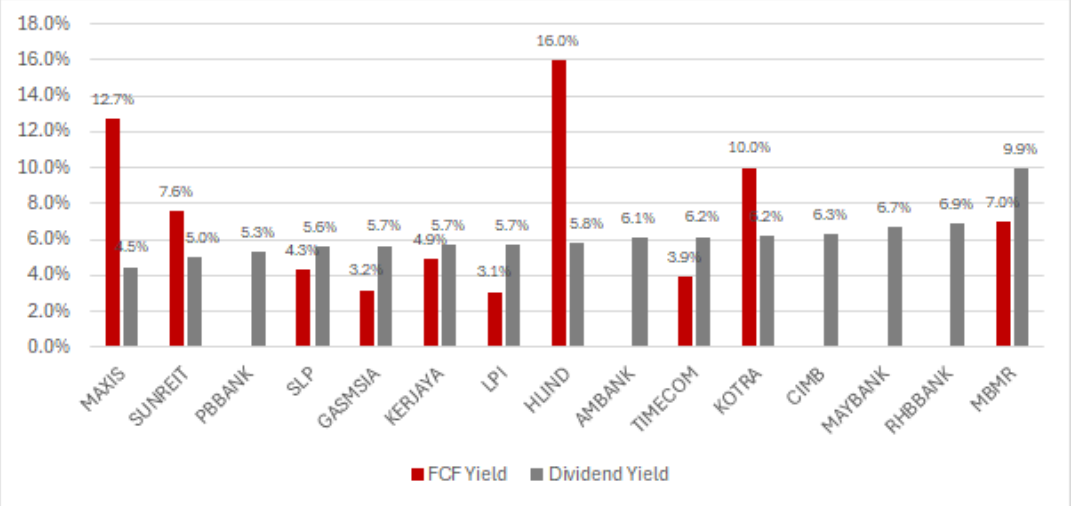
Exhibit 4: Performance of Selected Sectors During Periods of Bull-Steepening Yield Curve



Source: Kenanga Research, Bloomberg

Banking sector already reflecting pandemic level of loan growth expectation in ROEs and is fundamentally at a bargain level. The key for us is a strong GIL ratios for banks of <1.5%, which when coupled with the effect of a rate cut, could alleviate the need to top up on provisions. We believe investors will look to find more comfort in the area of growth. In this regard, banking analyst Clement Chua in his 10 July Sector Update estimated that all else equal, share-prices implied ROEs would commensurate with a loan growth for the system of 3.4% - which was essentially levels seen during Covid-19 (2020). This thus gives us confidence that the banks are undervalued. In the very immediate term, should bull-steepening bias materialize, historically it would be an uphill task for banks to outperform during such a stretch (exhibit 3). Our top pick remains **AMBANK** (OP; TP: RM6.90), which has prioritized profitability over market share goals. We also earlier highlighted that the lower interest rates would likely benefit high GIL lenders such as **MBSB** as well as **AEONCR** (OP; TP: RM6.25)**.**

Exhibit 5: Free-Cash Flow (FCF) Yield and Dividend Yield of Selected Dividend Plays

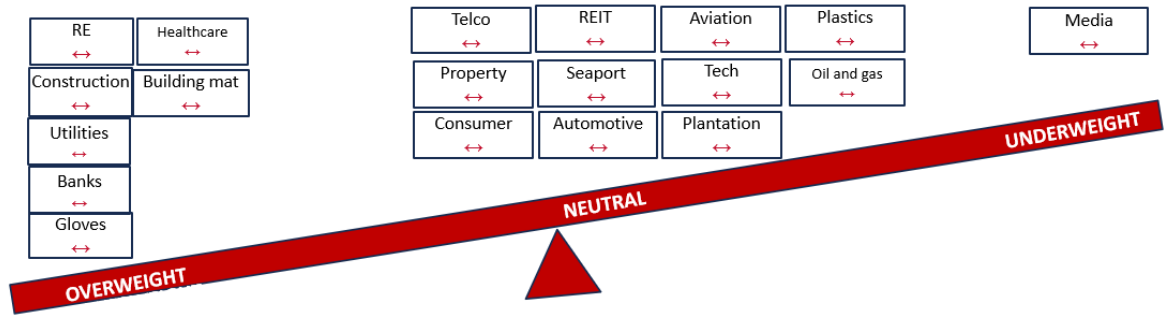


Source: Kenanga Research. Note that we have generally not shown FCF yield for banks. Note: we haven't included TENAGA and YTLPOWR in this list given that their dividend yields by our estimate is lower than 4.5%.

A rate cut without expectation of an economic contraction is bullish for REITs, but largely priced in current levels of MGS. Risk to the REIT sector earnings growth would be from the implementation of service tax, although a rate cut without GDP growth cut would likely be positive for the sector. As analysed in our latest REIT sector report (dated 10 July), the implied yield at the current moment at c.3.5% (MGS). This compares to 3.44% at time of writing. Our Kenanga forecast is for the year-end MGS to hover around similar levels and thus while the sector has momentum, we believe that fundamentally, the upside is more limited. Where we may be wrong is if more OPR cuts are deemend necessary - our coverage companies display a yield of 5.3% currently, and in the past decade we have seen the REIT sector trade at a level commensurating with yield of 4.6% during the pandemic.

Earnings trim follows slight revision in banks for NIMs, although we keep our FBM KLCI target for now. Our market earnings estimate, post the trim of the OPR is revised lower to 3.0% from 3.5%, with the adjustments purely made from the perspective of earnings cut due to putting through NIM impact for the banks, which ranged from 0 to 1.7% for FY25 (and 1 to 4% for FY26, on annualized basis). Please see banks sector update on 10 July 2025. However, we haven't given any compensating benefit of NOII uplift to the banks, which could materialize should banks crystalize some of their bond holdings that may have experienced positive revaluation gains. This could spell some upside to our banks earnings forecast of 3.7%. Thus, we keep our 1,655 year-end FBM KLCI target for now. Please refer to exhibits 7 to 9 for our market picks, which remain unchanged.

Exhibit 6: Relative Preference of Sectors



Source: various news, Kenanga Research

Exhibit 7: Top Conventional Picks and Key Investment Statistics

Stock	Stock Call	Last Price (RM)	Target Price (RM)	Upside	Market Cap (RM m)	FYE	EPS (sen)		EPS Growth (%)		PER (x)		PBV (x)	ROE (%)	NDPS (sen)	Div. Yield
							FY25F	FY26F	FY25F	FY26F	FY25F	FY26F	FY25	FY25F	FY25F	FY25F
CIMB	OP	6.68	7.90	18.3%	71,830.0	12/2025	75.1	77.9	4.0%	3.7%	8.9	8.6	1.0	11.3%	42.0	6.3%
TENAGA	OP	13.96	17.20	23.2%	81,375.0	12/2025	87.3	89.9	3.1%	3.0%	16.0	15.5	1.3	8.1%	43.2	3.1%
IHH	OP	6.58	8.11	23.3%	58,142.0	12/2025	21.6	24.3	12.6%	12.2%	30.4	27.1	1.9	6.2%	10.0	1.5%
TIMECOM	OP	5.20	5.91	13.7%	9,614.0	12/2025	26.3	28.9	11.1%	10.0%	19.8	18.0	2.5	12.6%	32.0	6.2%
YTLPOWR	OP	4.12	4.73	14.8%	33,495.0	06/2025	33.2	31.9	-19.0%	-3.8%	12.4	12.9	1.5	12.9%	7.0	1.7%
AMBANK	OP	5.15	6.90	34.0%	17,068.0	03/2026	63.8	65.9	5.4%	3.3%	8.1	7.8	0.8	10.0%	31.5	6.1%
TM	OP	6.65	8.15	22.6%	25,521.0	12/2025	47.4	47.6	-11.8%	0.4%	14.0	14.0	2.4	17.3%	33.0	5.0%
DIALOG	OP	1.62	1.94	19.8%	9,147.0	06/2025	8.6	8.7	-19.9%	1.5%	18.8	18.6	1.5	8.0%	4.0	2.5%
GAMUDA	OP	5.10	5.43	6.5%	29,276.0	07/2025	17.6	24.4	8.9%	38.7%	29.0	20.9	2.5	8.7%	10.0	2.0%
KGB	OP	3.93	4.33	10.2%	2,823.0	12/2025	20.4	19.5	25.2%	13.6%	19.3	20.2	4.4	26.7%	11.0	2.8%

Exhibit 8: Top Shariah Picks and Key Investment Statistics

Stock	Stock Call	Last Price (RM)	Target Price (RM)	Upside	Market Cap (RM m)	FYE	EPS (sen)		EPS Growth (%)		PER (x)		PBV (x)	ROE (%)	NDPS (sen)	Div. Yield
							FY25F	FY26F	FY25F	FY26F	FY25F	FY26F	FY25	FY25F	FY25F	FY25F
F&N	OP	28.60	31.95	11.7%	10,490.0	09/2025	157.7	169.6	2.5%	7.5%	18.1	16.9	2.7	15.5%	75.0	2.6%
TENAGA	OP	13.96	17.20	23.2%	81,375.0	12/2025	87.3	89.9	3.1%	3.0%	16.0	15.5	1.3	8.1%	43.2	3.1%
IHH	OP	6.58	8.11	23.3%	58,142.0	12/2025	21.6	24.3	12.6%	12.2%	30.4	27.1	1.9	6.2%	10.0	1.5%
TIMECOM	OP	5.20	5.91	13.7%	9,614.0	12/2025	26.3	28.9	11.1%	10.0%	19.8	18.0	2.5	12.6%	32.0	6.2%
IJM	OP	2.67	3.40	27.3%	9,739.0	03/2026	15.6	16.2	20.9%	4.0%	17.1	16.4	1.0	5.7%	8.0	3.0%
SIMEPROP	OP	1.57	1.79	14.0%	10,677.0	12/2025	8.0	8.1	36.7%	1.4%	19.6	19.4	1.0	5.2%	2.8	1.8%
TM	OP	6.65	8.15	22.6%	25,521.0	12/2025	47.4	47.6	-11.8%	0.4%	14.0	14.0	2.4	17.3%	33.0	5.0%
DIALOG	OP	1.62	1.94	19.8%	9,147.0	06/2025	8.6	8.7	-19.9%	1.5%	18.8	18.6	1.5	8.0%	4.0	2.5%
GAMUDA	OP	5.10	5.43	6.5%	29,276.0	07/2025	17.6	24.4	8.9%	38.7%	29.0	20.9	2.5	8.7%	10.0	2.0%
KGB	OP	3.93	4.33	10.2%	2,823.0	12/2025	20.4	19.5	25.2%	13.6%	19.3	20.2	4.4	26.7%	11.0	2.8%

Exhibit 9: Top Small Cap Picks and Key Investment Statistics

Stock	Stock Call	Last Price (RM)	Target Price (RM)	Upside	Market Cap (RM m)	FYE	EPS (sen)		EPS Growth		PER (x)		PBV (x)	ROE (%)	NDPS (sen)	Div. Yield
							FY25F	FY26F	FY25F	FY26F	FY25F	FY26F	FY25	FY25F	FY24F	FY24F
PIE	MP	4.07	4.60	13.0%	1,563.0	12/2025	17.8	21.3	28.4%	19.8%	22.9	19.1	2.2	10.2%	0.0	0.0%
KEYFIELD	MP	1.61	2.31	43.5%	1,299.0	12/2025	23.6	25.7	-14.0%	9.2%	6.8	6.3	1.6	25.4%	9.0	5.6%
PEKAT	OP	1.45	1.75	20.7%	935.0	12/2025	7.2	8.5	109.0%	17.5%	20.2	17.2	3.6	24.0%	0.0	0.0%
SLP	OP	0.865	1.00	15.6%	274.0	12/2025	5.0	5.3	12.1%	7.0%	17.5	16.3	1.5	8.3%	4.8	5.5%
DUOPHARMA	OP	1.38	1.72	24.6%	1,327.0	12/2025	9.9	11.5	51.8%	15.9%	14.0	12.0	1.7	12.8%	3.3	2.4%
SET	OP	0.290	0.600	106.9%	290.0	09/2025	1.9	2.4	3.3%	26.3%	15.3	12.1	3.7	27.9%	0.0	0.0%

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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